



## Federal Housing Finance Board

September 30, 1992

### MEMORANDUM

TO: Sylvia C. Martinez  
Director, Housing Finance Directorate

Through: Renie Y. Grohl *Ryg*  
Deputy General Counsel

FROM: Sharon B. Like *SL*  
Attorney/Advisor

SUBJECT: Use of AHP Funds for FHLBank Cancellation and Prepayment Fees

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Issue: Whether a Federal Home Loan Bank ("FHLBank") may charge the cancellation of prepayment fees applicable to a cancelled guaranteed-rate advance commitment to the Affordable Housing program ("AHP") subsidy funds committed to the cancelled project, rather than charge the fees to the member for the project.

Conclusion: A FHLBank's use of AHP subsidy funds' to pay for cancellation or prepayment fees applicable to cancelled AHP guaranteed-rate advance commitments would appear to contravene the intent and spirit of the Federal Home Loan Bank Act ("Bank Act") and AHP regulation to finance the purchase, construction or rehabilitation of affordable housing.

#### I. Background

You have requested legal advice from the Office of General Counsel ("OGC") on an issue raised by the FHLBank of San Francisco ("FHLBank-SF") regarding the use of AHP funds to pay for cancellation fees applicable to a cancelled AHP project.

Specifically, in 1991, the Federal Housing Finance Board ("Finance Board") approved an AHP project -- 525 O'Farrell Street -- submitted by the FHLBank-SF. The project was subsequently cancelled before any funds were disbursed by the FHLBank-SF to Citibank. As of June 30, 1992, the cost to the FHLBank-SF of cancelling the guaranteed-rate advance commitment was \$125,000, based on a spot consolidated obligation rate on that date of 7.61 percent. The FHLBank-SF has requested that it be allowed to charge this cancellation fee of \$9,125 to the unused AHP subsidy of \$41,486 that was committed by the FHLBank-SF to the 525

O'Farrell Street project, rather than assess the fee to Citibank, which it states was not responsible for the projects cancellation.<sup>1</sup>

The same issue also arises With respect to funded AHP advances for cancelled projects, where advances are prepaid by the member and the FHLBank imposes prepayment fees. In such cases, the FHLBank-SF would argue that the prepayment fees should be chargeable to the remaining unused AHP subsidy funds committed to the project, rather than to the member.

## II. Legal Requirements

### A. AHP Contractual Documents and Finance Board Advances Policy

Pursuant to the terms of the AHP contractual and other advances documents executed by Citibank, and FHLBank-SF and Finance Board advances policies, the FHLBank-SF currently is required to charge Citibank a cancellation or prepayment fee with respect to cancelled AHP projects, including a cancellation fee for 525 O'Farrell Street, unless the FHLBank-SF's board and the Finance Board both agree to waive the fee.

Staff at the FHLBank-SF has indicated that because of the economic cost to the FHLBank-SF's shareholders of waiving cancellation and prepayment fees, the FHLBank-SF's board generally has not waived prepayment fess and probably would not do so in Citibank's case. The FHLBank-SF therefore is not requesting that its board or the Finance Board waive the cancellation fee in the cast of 525 O'Farrell Street, but rather: that it be allowed to charge the fee to the unused AHP subsidy funds committed to the project.

### 8. Statutory and Regulatory Requirments

Section 10(j)(2) of the Bank Act provides that:

The Board's regulations shall permit Bank members to use subsidized advances received from the Banks to --

(A) finance homeownership by families with incomes at or below 80 percent of the median income for the area; or

(B) finance the purchase, construction, or

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1. Citibank also may be subject to a cancellation fee of \$500,000 in connection with cancellation of a guaranteed-rate advance commitment for the Tenderloin Family Housing project approved during the 1991 AHP round. As of March 19, 1992, the FHLBank-SF estimated that total cancellation fees for 21 cancelled guaranteed-rate advance commitments outstanding under the AHP was \$1.48 million.

rehabilitation of rental housing, at least 20 percent of the units of which will be occupied by and affordable for very low-income households for the remaining useful life of such housing or the mortgage term.

12 U.S.C. § 1430(j)(2) (emphasis added). Section 960.3(a)(1) of the Finance Board's AHP regulation implements this provision by providing that "[f]unds under each Bank's Program shall be used to provide subsidized assistance to members engaged in lending for activities ineligible to receive subsidized assistance under section 10(j) of the Act and this part." 12 C.F.R. § 960.3(a)(1) (emphasis added). Section 960.3(b) of the AHP regulation delineates the authorized uses of AHP subsidies as set forth in section 10(j)(2)(A) and (B) described above, see id. at § 960.3(b).

As the statutory and regulatory provisions indicate, Congress intended that the FHLBank provide AHP funds for the purchase, construction or rehabilitation of owner-occupied and rental housing for low-income households. Allowing the FHLBanks to use AHP funds for: cancellation or prepayment fees when no affordable housing is being purchased, constructed or rehabilitated would appear to contravene the intent and spirit of the statute and AHP regulation to provide subsidized assistance for: the actual development of affordable housing. The FHLBank-SF argues that Citibank should not have to pay the cancellation fee because it was not responsible for the cancellation of the 525 O'Farrell Street project. However, as noted above, the statute and AHP regulation specify the authorized uses for AHP funds, and these uses do not appear to include cancellation fees, or a consideration of who was at fault in causing the imposition of the cancellation fees.

Section 960.3(c) of the AHP regulation also provides that "[p]rogram funds may only be used for direct costs required to produce and/or finance affordable housing units." Id. at § 960.3(b) (emphasis added). The AHP regulation does not further define the term "direct costs." However, the Preamble to the regulation states that "AHP funds should not be used to pay or defray indirect or third party costs not standard for housing finance transactions." 56 Fed. Reg. 8688, 8690 (March 1, 1991). Thus, soft costs such as third party counseling fees would not be considered direct costs under the regulation. On the other hand, predevelopment costs, such as architectural or engineering fees, may be considered permissible direct costs under the AHP regulation, as these are standard costs typically preceding the construction of housing units. Cancellation and prepayment fees, while arguably associated with the financing of housing, are not the actual costs of predevelopment or development of housing. Rather, they are the costs to the FHLBank of making

guaranteed-rate advance commitments.<sup>2</sup>

In short, in view of the purpose of the AHP statute and regulation to finance the actual purchase, construction or rehabilitation of housing and the direct costs associated therewith, the use of the FHLBank-SF's committed but unused AHP funds to pay for the cancellation fees on the 525 O'Farrell Street project would appear to contravene the intent and spirit of the AHP statute and regulation.

### III. Conclusion

A FHLBank's use of AHP subsidy funds to pay for cancellation or prepayment fees applicable to cancelled AHP guaranteed-rate advance commitments would appear to contravene the purpose and spirit of the Bank Act and AHP regulation to finance the purchase construction or rehabilitation of affordable housing.

cc: Beth L. Climo

bcc: Richard Tucker

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**2. This does not mean that funds actually expended on direct costs, such as predevelopment costs, for an AHP project must be recaptured if the project is subsequently cancelled. Section 960.8 of the AHP regulation requires only that the amount of any committed but unused subsidy or improperly used subsidy be recovered and made available by the FHLBank for future projects. See 12 C.F.R. § 960.8. In this connection, section 960.8 also lists the calling of unused advances and the assessment of prepayment fees as actions a FHLBank may take, in its discretion, to recapture unused or improperly used AHP subsidies. Id. at § 960.8(b)(2), (3).**